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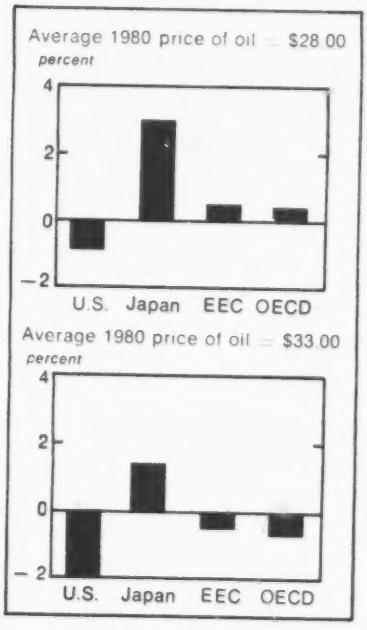
The World Economy in 1980—At Best a Major Slowdown

The outlook for the performance of the world economy in 1980 can only be characterized as bleak. Even under "favorable" assumptions as to the price and availability of oil, the overall growth of output in the industrialized nations is likely to be barely positive, and the volume of world trade should show little if any change.

Although among the major economies only the United States and the United Kingdom are likely to experience full-blown recessions, virtually every non-OPEC nation, developing as well as developed, will suffer a major growth slowdown. And if further developments in the U.S.-Iranian confrontation should trigger a significant squeeze on oil supplies and another major hike in oil prices, this contraction will almost certainly achieve the proportions of a world recession—with a significant drop in aggregate output in the OECD economies and an even sharper fall in the volume of international trade. Furthermore, these worsened growth prospects will not be accompanied by any significant improvement in the outlook for inflation. Even under optimistic assumptions about oil prices, the rate of inflation in most industrialized countries is likely to be only marginally less in 1980 than in 1979. In some—Japan and Italy in particular—inflation will accelerate somewhat.

1980 growth projections
(change in real GNP, 4Q '79 to 4Q '80)



Another disturbing element in the outlook for 1980 is the emergence of a pattern of international payments imbalances that implies not only significant funding problems for many countries, but also major stresses for the international monetary system. The prospective funding difficulties of the non-oil developing countries have been well-publicized; To avoid a major disruption in international capital markets, not only must the volume of official lending increase, particularly from multilateral organizations, but the growth plans of many developing countries will have to be scaled back.

Equally demanding of policy attention, however, is the anticipated stress on the international monetary system. The stress will arise from the desires of the OPEC nations to increase the share of non-dollar assets in their reserve portfolios and the limited willingness of foreign central banks to allow their currencies to perform reserve-asset roles. It may be possible to alleviate the stress somewhat with a new policy initiative that could take one of several forms—such as issuing indexed official debt on an off-market basis by the major oil-importing nations (defined either in SDRs or in their own currencies) to the surplus OPEC countries. Without some such innovation, the ingredients are in place for renewed instability in the foreign-exchange markets.

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WESTERN EUROPE

The European economies posted average growth of 2.3% in 1977, 3.0% in 1978, and an estimated 3.8% in 1979, but the 1980 outlook is for a sharp slowdown to some 1.5%. The anticipated decline will stem from higher oil prices and restrictive monetary policies adopted by the larger European economies to curb inflation. The slower growth may, however, permit a containment of the aggregate current-account deficit to the $20-billion level recorded in 1979 and hold the rate of inflation to its 1979 pace.

The **British** economy is expected to weaken in 1980 as a result of declining demand for U.K. exports stemming from sterling's sharp appreciation in 1979. The high rate of inflation anticipated—an average 16%—is likely to lead to some decline in sterling toward year-end, which could be reinforced by capital outflows stimulated by the recent abolition of foreign-exchange controls.

Domestic economic activity in **France** strengthened in late 1979. Inflationary expectations triggered strong demand for consumer durables and inventory building. In 1980, weaker domestic and external demand will produce real growth of less than 2.5%. Although curbing inflation will remain a priority, prices are still expected to rise at an average annual rate of 11%. And on the external front, the current account will return to deficit.

In **West Germany,** the restrictive monetary policy prevailing since mid-1979, combined with the deflationary impact of higher oil prices, is expected to restrain domestic demand. At the same time, slowdowns abroad will curb exports. Real GDP growth in 1980 is estimated at 2%, less than half that of 1979, with a recession a distinct possibility. Despite wage settlements exceeding the 4%-5% of 1979, the inflation rate will probably fall throughout 1980; still the year-average rate is projected at 5.2%. Last year saw Germany's first current-account deficit since 1965, and higher oil prices, together with the real appreciation of the DM, will further weaken the current account in 1980.

Renewed inflationary pressures have emerged in **Italy** after several years of expansionary policies. The authorities responded by tightening monetary policy in late 1979. As in Germany, real growth is expected to be halved, and further tightening or another substantial oil price hike could turn a slowdown into a recession.

Switzerland's inflation rate, currently running at 5%+, annualized, is a concern for the authorities. Although well below the international average, it is the highest recorded since 1975. In response, a further tightening in monetary policy led to sharply higher interest rates in the final quarter of 1979. Measures were also taken to bolster the franc, in sharp contrast to the situation at end-1978. In 1980, the average rate of inflation is expected to approximate the 3.6% of 1979. Domestic activity will likely weaken around midyear in response to restrictive monetary policy and the anticipated slowdown in external demand.

Developments in the **Scandinavian** economies usually lag those elsewhere in Europe, so that growth will probably continue strong through midyear. Toward end-1980, however, recessionary forces abroad will show up in falling export demand.

WESTERN HEMISPHERE

In 1980, the economies of the Western Hemisphere will be buffeted to varying degrees by the economic slowdown in the OECD countries, the rising price of oil, and the resurgence of inflationary pressure.

The outlook for **Canada** is for 1% GNP growth, with a slight decline in the rate of inflation from the 9% of 1979. The U.S. slowdown will reduce Canadian exports and help boost the current-account deficit to C$8 billion from C$7.0 billion in 1979.

In Latin America, **Brazil** is likely to be most affected by soaring OPEC oil prices. With oil imports heavy, the current-account gap could reach $12 billion in 1980, compared with $10 billion in 1979. Brazil has already adopted contractionary fiscal policies and has devalued the cruzeiro by 30%, actions that are likely to trim the rate of GDP growth to 5.5% from 7.1% in 1979. The rate of price rise could fall to 60% by year-end from near 80% as of end-1979 if policies of demand moderation are diligently pursued. But with large financing needs projected for 1980, Brazil will have to perform strongly to win the confidence of the international financial community.

Elsewhere in Latin America, **Mexico** will continue to ride its oil and investment boom; real GDP should approach 7% after 7.5% growth in 1979. But demand and supply pressures are likely to push the country's inflation rate above 20%. For **Argentina,** the major challenge continues to be the reduction of the country's high inflation rate; the goal is to lower the rate to below 100% from 140% at year-end 1979.

Among the countries of the Andean region, **Venezuela** is likely to continue on a cautious economic growth path, while higher OPEC oil prices will enhance its payments balance. **Ecuador** is faced with the task of setting economic development priorities as exploration for new oil sources intensifies. **Peru's** remarkable recovery will strengthen further in 1980, since the country is now a net petroleum exporter; but its prospects are tempered by a stubbornly high inflation rate. **Bolivia** has recently embarked on an economic stabilization program designed to correct its internal and external imbalances. And **Colombia's** economic expansion is likely to slow in the face of more restrictive credit policies. In **Chile,** the authorities will be confronted with an inflation/unemployment trade-off as they seek to cut the rate of price increase below 30%.

In the Caribbean, **Puerto Rico** will feel the pinch of declining U.S. economic activity. Since real GDP rose by a solid 5.4% in the fiscal year ended June 1979, however, the island is cushioned to absorb some slowdown in U.S. demand for its manufactured exports. In the **Bahamas** and **Trinidad,** economic activity is expected to continue brisk, buoyed, respectively, by tourism and petroleum earnings. The **Dominican Republic's** external position will continue weak, despite higher sugar prices, because of import needs associated with the country's reconstruction effort and higher petroleum costs. For **Jamaica,** 1980 promises continued austerity and foreign-exchange scarcity.

In Central America, **Nicaragua** faces the task of reconstruction and debt renegotiation, while **Honduras** should experience another year of healthy growth in the 7% range. **Guatemala's** pace of economic expansion is likely to slow from the high rate of nearly 6% attained in the previous four years. And **Panama** and **Costa Rica** are both expected to experience moderate growth, with possible inflationary pressures stemming from higher oil prices.

ASIA-OCEANIA

Japan enters 1980 with some uneasiness. Its high dependence on imported petroleum makes it especially vulnerable to oil price and supply developments, which are likely to have an adverse impact on the Japanese economy in 1980. The outlook is for slower growth with higher inflation. Real GDP is projected to rise about 4% as the economy begins to slow in the second half. Real growth in consumer spending is expected to slacken to about 3%-4%; the inflation rate is likely to climb to about 9%; and private investment will weaken from its current strong pace. Export volume is likely to accelerate as a result of the yen's weakness in 1979, but higher oil prices and relatively firm domestic demand should keep imports strong; the current account is thus expected to remain in deficit.

With world trade expected to be down next year, most Asian countries will see their balance of payments deteriorate, and some may have difficulty financing their deficits. In the newly industrialized countries, real growth is likely to be restrained. **Taiwan's** real GNP growth is projected at around 7.5%, as export growth slackens. **Korea** will continue with its stabilization program after three years of economic overheating. While real growth will drop to perhaps as low as 4%, the current-account gap is likely to exceed $4 billion. In **Hong Kong,** economic activity is likely to moderate, and the trade deficit should total slightly less than the $2 billion in 1979. **Singapore's** shift to a higher wage policy is intended to enhance productivity and contribute to more stable economic growth in the future.

The payments balances of **Thailand** and the **Philippines** should continue to worsen in 1980, with more stable commodity export prices and higher oil import prices anticipated. Real economic growth will drop to 6% and 4.5%, respectively. **Malaysia** will also experience a slowdown in real GDP growth, and its current account will move from balance in 1979 into sizable deficit. **Indonesia's** economy is buoyed by higher oil prices, and real growth is likely to be about 6.5% in 1980. Still, declining oil output and higher domestic consumption will require the Government to intensify diversification efforts. In South Asia, **India's** severe drought in 1979 is expected to curtail agricultural output, and real growth could decline to about 2% this year. With good harvests in 1979, **China's** real growth is expected to rise to about 6% in 1980. The current-account deficit, however, will be quite large and will force the Chinese to tap previously arranged credit commitments.

Australia's economy will grow about 3% in 1980, fueled by increased consumer spending, domestic and foreign investment, and strong agricultural exports. While inflation should hold at about 10%, prospects for unemployment and the balance of payments are not favorable. In **New Zealand,** a resurgence of inflation will accompany sluggish economic growth, weak exports, and reduced government spending.

MIDDLE EAST-AFRICA

The sharp jump in oil prices expanded the OPEC current-account surplus to an estimated $55-$60 billion in 1979. The surplus is expected to increase sharply again this year to between $85 and $90 billion, even without any further supply disruptions and despite expectations of reduced oil output. The bulk of the surplus, of course, will accrue to the Persian Gulf countries.

The likelihood of continued economic disruption in **Iran** into 1980 will constrain growth of imports and contribute to an enlarged financial surplus. **Saudi Arabia** will unveil its third development plan (1980-84), which should indicate whether the re-emergence of conservatism on the Arabian Peninsula has induced the Saudis to curtail growth substantially. Some of the smaller states in the region, such as **Qatar**, the **UAE**, and **Oman**, are expected to accelerate development spending in 1980. **Egypt** will continue to earn substantial income from oil, foreign remittances, Suez Canal tolls, tourism, and a good cotton crop in 1980, but will remain heavily dependent on Western aid. Economic activity in **Morocco** will continue dampened by an austerity program; it will also remain dependent on external loans and grants. In **Algeria**, however, higher revenues from hydrocarbon exports and a shift in emphasis away from import-intensive heavy industry suggest reduced external capital needs. **Tunisian** economic growth will accelerate significantly this year, led by exports and investment. **Syria's** economy is also expected to strengthen in 1980, as a result of higher oil revenues and Arab aid, while **Jordan** should see another year of steady growth. **Israel's** very high inflation rate prompted the Government to introduce austerity measures that will probably halve 1980 GDP growth to some 2.5%.

In **Sub-Saharan Africa**, the mineral-exporting countries should see strong exports this year, although current-account surpluses are likely to narrow from 1979 levels because of rising imports and invisible payments. Oil-rich **Nigeria**, whose current account posted a $2.3-billion surplus last year, should register a weaker surplus in 1980. **Gabon**, one of OPEC's smallest producers, can also be expected to hold its current account in the black. Sharply higher gold prices gave **South Africa** a current-account surplus of almost $4 billion last year and will continue to bolster export receipts in 1980. But imports will also increase, as economic growth is forecast to advance 4.5%. **Zambia's** small current-account surplus in 1979 is likely to fade in 1980, with the lifting of sanctions on Rhodesia likely to foster the inflow of much-needed imports. Among the agricultural exporters, **Kenya**, **Ivory Coast**, and **Cameroon** will continue dependent on volatile world prices for coffee, cocoa, and tea. Even with a repeat of last year's relatively good earnings, 1980 promises continued large current-account deficits and slower real growth.

Latin America Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1978		BALANCE OF
		3 months ending	change from year earlier	in billions of dollars	per capita	latest data
Argentina	Signs of economic slowdown after fast growth in first three quarters; inflation rate dropping.	Oct.	+ 23%	61.0	$2,260	Sept.
Bolivia	New civilian government unveils austerity program of budget/money controls and limited wage rises.	June	+ 23%	4.0	650	Nov.
Brazil	Cruzeiro devaluation of 30% is part of price and trade liberalization program.	Oct.	+ 20%	190.9	1,654	Aug.
Chile	Industrial production up about 9% in 1979, with manufacturing showing largest increase.	July	+ 68%	15.6	1,440	Nov.
Colombia	Massive, 42-million-ton-capacity Cerro Matoso ferronickel project given construction go-ahead.	Oct.	+ 20%	23.1	895	Nov.
Costa Rica	Government investing heavily in construction of major highway networks and housing facilities.	Aug.	+ 8%	3.5	1,650	Nov.
Dominican Rep.	Hurricane reconstruction continues; much of damage to productive capacity already repaired.	Sept.	+ 32%	4.4	860	Nov.
Ecuador	Faster progress being made in developing oil and natural gas deposits.	Apr.	+ 19%	7.2	924	Oct.
El Salvador	Minimum wage in agricultural sector increased; price controls more vigorously enforced.	Mar.	+135%	3.2	730	Nov.
Guatemala	Government cites new areas for oil exploration and exploitation, but few oil firms respond.	Dec. '78	— 5%	6.3	942	Nov.
Honduras	Large public investments in physical and social infrastructure keep economic growth in 7% range.	May	+ 16%	1.7	570	Oct.
Mexico	Economic output high; manufacturing and oil production rising at 10% + annual rate.	Sept.	+ 40%	92.8	1,386	Aug.
Nicaragua	Reconstruction effort begun; agriculture, source of 80% of foreign-exchange earnings, given priority.	Mar.	+ 19%	2.4	995	Nov.
Panama	President announces eight-point program of economic development; objective is 5% GDP growth.	June	+ 20%	3.4	1,868	Oct.
Paraguay	Economy expanding vigorously, owing to construction and agriculture booms; inflation is accelerating.	Aug.	+ 16%	2.6	900	Nov.
Peru	IMF seeks end to dollar certificate sales and tax rebates for non-traditional exports.	Aug.	+182%	10.7	640	Oct.
Trinidad & Tobago	Agricultural output adversely affected by sugar harvest problems; industrial production strong.	May	+ 5%	3.6	3,215	Nov.
Venezuela	Higher OPEC oil price will increase export earnings and strengthen balance of payments.	July	+ 41%	41.2	3,150	Oct.

BALANCE OF				
reserves (less gold) in million $	12-month change	months of imports covered	use of credit lions of
8,730	+ 63%	25.2	0
152	+ 11%	2.0	19
9,769	0	6.7	0
1,811	+ 72%	6.0	178
3,681	+ 65%	13.6	0
96	— 47%	1.3	57
209	+107%	2.1	121
672	+ 11%	4.4	0
190	— 24%	2.4	0
666	— 10%	6.6	0
159	— 17%	3.1	0
1,943	+ 8%	2.2	129
110	— 66%	1.7	56
131	+ 21%	1.8	47
627	+ 39%	12.4	0
975	+112%	7.8	457
1,797	+ 3%	12.4	0
5,590	— 12%	5.5	0

COMMODITIES

Prices of most commodities are expected to weaken during 1980, owing to a deepening U.S. recession and a slowing of economic activity in Europe and Japan. As the year begins, however, economic and political uncertainties point to the possibility of extremely volatile market conditions. On a fourth-quarter to fourth-quarter basis, average **oil** prices may increase as much as 15%, but most of this increase is already behind us. This assumes no major squeeze on oil supplies resulting from an intensification of the U.S.-Iranian confrontation.

Precious metal prices, driven skyward by the return to double-digit inflation and political uncertainties, are all susceptible to sharp corrections. Investment demand for **gold, silver,** and **platinum** could decrease as U.S. inflation begins to decelerate—especially if the dollar strengthens—while severe industrial supply shortages of silver and platinum appear to have ended.

Among the base metals, **zinc** is suffering from excessive inventory accumulation because of sluggish auto demand, and further downward pressure on already-low prices is expected. **Lead** prices have begun to turn down from record levels, and barring a resumption of heavy purchases by the Soviet Union, they should continue to decline as the U.S. auto slump spreads abroad. **Copper** prices have been pushed up by a spillover of speculative demand from the precious metals market. An expected decline, however, could be interrupted by a U.S. copper workers' strike at midyear when current contracts expire. Passage of legislation authorizing the sale of excess **tin** from the U.S. strategic stockpile should add to the downward pressure on prices resulting from weakening demand. Market prices for **aluminum** are also expected to weaken, but declines will be limited by the high energy costs of marginal producers.

Assuming both more normal grain crops in the Soviet Union and increased acreage in the United States, prices of **corn, wheat,** and **soybeans** are expected to fluctuate around their year-end 1979 levels. Little change is also foreseen for **pork** and **poultry** prices, owing to ample supplies, and with the rebuilding of cattle herds after four years of liquidation, increases in **beef** prices this year should be less than half those of 1979.

Coffee and **cocoa** prices should drift downward as a result of higher production and growing surpluses, despite market actions by producing countries. **Tea** prices, however, could increase from current low levels because of the recent drought in India. **Sugar** prices could also rise, owing partly to the likelihood of the first drawdown in world raw sugar stocks since 1972-73.

Prices of **cotton, wool,** and natural **rubber** will weaken in 1980, reflecting declining demand. But any such declines will be moderated by the sharply higher cost of producing synthetic, petroleum-based substitutes.

YMENTS		MONEY AND BANKING							COUNTRIES
MF nil- llars	current influences on payments	12-month changes latest data	consumer prices	latest data	domestic credit	central bank rate	exchange rate in U.S. dollars January 2, 1980	current monetary conditions	
	Record inflow of foreign loans.	Nov.	+150%	Sept.	+184%	18.00%	.00065	Some easing of peso lending rates.	**Argentina**
	Peso devalued 25% in effort to close widening trade gap.	Aug.	+ 17%	July	+ 3%	—	.0520	Monetary policy is restrictive.	**Bolivia**
	Withholding tax rebate raised to 95%; import and loan deposits removed.	Nov.	+ 68%	June	+ 48%	33.00%	.0250	Credit subsidies reduced.	**Brazil**
	Price rises boost copper export earnings.	Oct.	+ 37%	Aug.	+ 48%	—	.0275	Domestic interest rates stabilize.	**Chile**
	Coffee export volume for Jan.-Oct. 1979 up 34% from year-earlier level.	Sept.	+ 26%	Sept.	− 27%	20.00%	.0265	Credit crunch prevails.	**Colombia**
	Trade deficit widening; expected to exceed $500 million.	Aug.	+ 9%	Aug.	+ 42%	8.00%	.1200	Credit to private sector restrictive.	**Costa Rica**
	Capital inflows reducing 1979 current-account gap to some $300 million.	May	+ 6%	July	+ 6%	—	Par	Credit growing in line with increased demand.	**Dominican Rep.**
	Spot oil price reaches $45 per barrel.	Sept.	+ 9%	June	+ 40%	8.00%	.0400	Bank reserve requirements cut.	**Ecuador**
	Coffee exports in 1979 up 30% above previous year's level.	Aug.	+ 7%	Aug.	+ 4%	—	.4030	Credit policy restrictive.	**El Salvador**
	Nickel exports in first ten months of 1979 double year-earlier level.	Aug.	+ 10%	Aug.	+ 33%	—	Par	Credit is scarce.	**Guatemala**
	Current-account deficit continues to widen.	July	+ 9%	Apr.	+ 17%	4.00%	.5025	Access to foreign credit eases internal credit crunch.	**Honduras**
	Larger trade deficit offset by capital inflows.	Sept.	+ 18%	Aug.	+ 28%	4.50%	.0450	Slight reduction in money supply growth.	**Mexico**
	Negotiations begun to reschedule external public debt.	Sept. '78	+ 4%	Apr.	+ 45%	—	.1030	Credit is scarce.	**Nicaragua**
	Panama Canal tolls increased 29.5% in October.	July	+ 9%	June	+ 8%	—	Par	Slow growth in domestic credit.	**Panama**
	Large capital inflows spurred by hydroelectric projects.	Sept.	+ 34%	June	+ 20%	—	.0081	Limits placed on credit expansion.	**Paraguay**
	Import liberalization stepped up; export growth continues at record levels.	Aug.	+ 65%	July	+ 37%	29.50%	.0045	Liquidity growth is excessive.	**Peru**
	Oil price increase will boost export earnings.	Sept.	+ 17%	June	+ 34%	6.00%	.4300	Some restraints on bank lending.	**Trinidad & Tobago**
	Reserves trending upward in recent months.	Aug.	+ 12%	June	+ 34%	8.50%	.2335	Commercial bank liquidity under pressure.	**Venezuela**

World Interest Rates

market rates of January 2, 1980; bond yields as of December 28, 1979

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00	14.00	17.00	10.50	9.50	6.00	15.00 penalty rate 18.00	9.50	2.00	6.25
Day-to-Day Money	13.75 Jan. 3	15.00	16.00	12.35	12.375	8.10	16.00*	10.75	1.25*	8.25**
Treasury Bills 91-day, Middle Rates	12.18	13.60	15.8125	14.40 120-day	n. a.	n. a.	15.26*	no dealing	no market	5.625** 2-month
Commercial Paper prime, 3-month, asked	12.00 finance paper	14.10 finance paper 15% tax w/h	14.80	10.40 Certified	12.8125 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	13.00	14.00 15% tax w/h	16.50	12.50 Certified	not traded	8.40	n. a.	no market	3.25* not traded	no market
Government Bonds Long-term, new and old issues, average yield	10.07	11.62	14.32	10.40 20% tax w/h	11.83	7.85	14.03*	9.36	4.17*	8.15**
Industrial Bonds prime, long-term, new and old issues, average yield	10.35 Aa Industrials	12.00	14.89	12.07 20% tax w/h	12.92	8.09	14.41*	10.34	5.39*	6.95**
Bank Short-Term Rate to Best Borrowers (prime rate)	15.25	15.00	18.00	15.25	13.10	9.75	20.00*	15.50	4.00*	6.50**
Bank Time Deposits 3-month	13.125 Cert. of Dep.	13.95 Cert. of Dep.	16.875	14.45	12.875	8.95	10.75*	13.00 large deposits	6.3125* residents only	4.00** 20% tax w/h
Eurocurrencies 3-month, asked	14.0625	no market	16.9375	no market	14.00	8.375	no market	11.375	5.625	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8584	2.2280	.03570	.2482	.5827	.001248	.5289	.6330	.004200
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	.65 *P*	2.80 *D*	.20 *D*	FLAT	5.70 *P*	3.50 *D*	2.50 *P*	8.80 *P*	5.90 *P*

Eurodollar Deposits
(London, interbank, bid)
January 3

7-day	14.0625
1-month	14.50
3-month	14.5625
6-month	14.5625

International Arbitrage
(3-month, hedged) *+ in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	− .62
U.S.-Canada Treasury Bills	−1.44
U.S.-Canada Finance Co. Paper	−2.56
Eurodollars-U.K. Local Auth. Deposits	+ .11

Eurbonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.75
Over 7 yrs.	12.00
DM Bonds	
7 yrs. and under	7.875
Over 7 yrs.	8.25

Gold Price
London afternoon fixing
559.50
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

° Market Rates as of Dec. 19; bond yields as of Dec. 14, 1979. °° Market Rates as of Dec. 26; bond yields as of Dec. 21, 1979.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	12.6 (Nov.)	9.4 (Nov.)	17.4 (Nov.)	12.8 (Nov.)	5.3 (Nov.)	18.7 (Nov.)	5.2 (Nov.)	4.2 (Oct.)
Industrial production*	0.7 (Nov.)	−0.8 (Nov.)	3.4 (Oct.)	3.1 (Oct.)	4.2 (Oct.)	3.6 (Oct.)	4.0 (Sept.)	8.0 (Oct.)
Trade balance† *(billions of local currency units)*	−$1.42 (Nov.)	C$.326 (Oct.)	−£.05 (Nov.)	−FF1.28 (Nov.)	DM1.51 (Nov.)	−Lit10 (Oct.)	−SF.386 (Nov.)	−¥546 (Nov.)
Money supply (M_1)*	5.1 (Nov.)	8.5 (Oct.)	14.9 (Oct.)	12.0 (Aug.)	6.0 (Aug.)	19.9 (June)	6.8 (Aug.)	8.4 (Oct.)
Velocity of money (M_1)*	6.6 (June)	5.8 (June)	−2.1 (Mar.)	11.5 (Sept.)	−0.3 (June)	−2.2 (Mar.)	n.a.	−1.4 (June)
Reserves minus gold *($ million, change from previous month)*	+1,350 (Nov.)	−35 (Nov.)	+249 (Nov.)	+661 (Oct.)	+3,445 (Nov.)	−44 (Nov.)	+562 (Nov.)	−3,120 (Nov.)

* Percent change from 12 months earlier.

† Figures are only for the month indicated.

The U.S. Economic Outlook

There was little economic growth in the United States in 1979—less than 1%, measured from fourth quarter 1978 to fourth quarter 1979. Some sectors of the economy weakened significantly during the year, and the weakness appeared to be spreading as the year ended. Most economists now expect outright declines in U.S. economic activity through most of 1980. The key reason: a persistent rise in consumer prices at annual rates of about 13%, which has eroded consumers' real purchasing power. In addition, high interest rates—partly a policy response to inflation— have restricted housing construction. And the sharp increase in gasoline prices, along with temporary shortages, has cut demand for large U.S.-made automobiles.

Sales of automobiles (including imports) totaled 11.2 million units in both 1977 and 1978; they began 1979 at an even higher rate. But rising gasoline prices, fears of gasoline shortages, and the weakness in real consumer income combined to reduce the sales rate sharply as the year advanced; for the last three months of 1979, the annual sales rate was about 9.3 million. Total sales were 10¾ million units in 1979, with an additional drop of a million units or more expected in 1980. Virtually all the decline has been (and will be) experienced by U.S.-made vehicles. Sales of imported cars—mostly small, fuel-efficient models—have continued strong. Sales of consumer products other than automobiles held up reasonably well during 1979, but exhibited little growth in real volume. Modest declines appear likely in early 1980, with some recovery possible late in the year.

Capital investment has presented something of a mixed picture. Rising interest rates pushed construction of new housing down throughout 1979. The very large increase in rates beginning in early October further depressed the market. Construction was started on about 1¾ million new housing units during 1979, down from 2 million in both 1977 and 1978. But the rate of new starts was falling sharply as the year ended; they seem likely to total 1.45 million units or less in 1980. Capital spending by business meanwhile showed a solid gain for the year, although investment in new trucks and cars declined. Orders for capital equipment did, however, appear to be slipping toward year-end.

Opinions vary as to the probable severity of the recession that appears to be developing in the United States. Most economists expect it to be relatively mild, primarily because of the absence of the kind of speculative excesses that preceded the exceptionally severe 1974-75 recession. In particular, business inventories have been held under tight control, so that any necessary adjustment in that sector may be relatively modest.

Perhaps the greatest unknown (aside from oil-related matters) concerns the outlook for inflation. Recessions usually produce some temporary easing in the inflation rate. U.S. prices will continue to rise rapidly this winter, but there is considerable hope for a drop to lower rates in the late spring or summer. Along with a decline in interest rates, this would permit some improvement in real incomes and could help set the stage for a general economic recovery beginning later in the year.

Inflation will, however, remain a major domestic problem. Wages and salaries will probably increase even more in 1980 than in 1979. This could pave the way for a return to more rapid price inflation in the future, unless the tendency is countered by a continuation of current, relatively conservative monetary and fiscal policies. It may be difficult to stay with such policies as the unemployment rate rises over the course of the year.

Interest rates to decline slowly

The 1980 interest rate outlook hinges—as is generally the case—on the interaction of unemployment, inflation, and Federal Reserve policy. Two of these have been assessed above. First, the rate of unemployment is expected to begin rising as the economy weakens, but increases will be on the moderate side. Second, inflation conditions will not improve appreciably until around midyear. And even after that, the limited extent of the recession, plus persistent cost pressures (particularly from labor and energy), will impede any material slowing of inflation in the latter part of 1980.

In this environment, Federal Reserve policy will have to take account of difficult and interrelated problems with the dollar and inflationary expectations. The dollar is likely to be under pressure during much of 1980, despite some improvement in the U.S. trade deficit (chiefly in the first half) and a better inflation record (mainly in the second half). The tendency for dollar weakness will reflect sustained high interest rates abroad and the prospect of some further shifts in currency preferences of OPEC members and others.

Inflationary expectations in the United States seem to have become deeply ingrained in economic sentiment. To be sure, it is virtually impossible to estimate how intractable these expectations have become. But—at a minimum—to avoid validating pessimistic views that inflation may *never* abate appreciably, the Federal Reserve will be obliged to exercise caution in moving toward monetary stimulus in response to the slowing economy and concomitant slower money growth. And the risks of aggravating dollar weakness similarly will point to caution in policy shifts.

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While it is reasonable to expect monetary policy to continue the greater emphasis on managing bank reserves and money growth announced last October, deliberate interest rate management will probably have a major role at times. The new emphasis on money growth obviously has been implemented within a much wider band of Federal funds rates than was previously the case. But the adjustment of that rate band to changed conditions is a function of discretionary monetary management. For example, assuming a long-run M_1 growth target of 4½%-6%, M_1 growth of 3% in first-quarter 1980 would not necessarily trigger an automatic adjustment of the target range for Federal funds to, say, 8%-12%. Indeed, a major uncertainty in monetary policy during 1980 will be the extent to which the Federal Reserve will tolerate money market rates that are appreciably below the contemporary inflation rate.

In brief, short-term rates are projected to decline over the course of 1980, but probably not more than 4-5 percentage points in total—and most of that after mid-1980. This view represents something of a compromise: on the one hand, rates will come down because, under similar economic circumstances in the past, they generally have. On the other hand, declines will not be so large or so early as in the past because of the problems of domestic inflation and weakness of the dollar. The most likely outlook incorporates an expectation that last November's rate peaks will not be exceeded. If something "goes wrong" in the next few months, it may well be in the direction of some combination of more sustained growth, higher inflation, and severe dollar weakness. In this case, 1980 would bring new interest rate peaks in the first half.

U.S. external-account outlook uncertain

Last year was a banner year for U.S. exporters, with exports up some 28% over 1978 levels. Were it not for the huge oil price shocks, the U.S. trade deficit would have narrowed dramatically, since non-oil imports grew only at about the rate of inflation. However, with the oil bill for 1979 about 50% above 1978, the overall deficit was reduced only by some $4 billion. Fortunately, the U.S. services surplus skyrocketed along with oil costs; it advanced by some 40%. Overall, the U.S. current account moved from a deficit of $13.9 billion to a position of near balance.

The U.S. external picture for 1980 is riddled with uncertainty. The current account is expected to continue its long climb back to surplus as a result of continued unsynchronized world growth through midyear, but OPEC pricing strategy and foreign real growth slowdowns toward year-end temper any optimism about U.S. exports during the second half. Moreover, the export slowdown is expected to coincide with U.S. import demand reversing course and picking up as the economy revives. Thus, the 1980 current-account balance could range anywhere between a deficit of $3 billion and a surplus of $5 billion.

Export growth for 1980 could drop to between 12% and 15%, with agricultural exports providing much of the momentum. Non-agricultural exports, which boomed in 1979, are expected to lag in 1980. They will be hurt badly by the slowdown in foreign growth expected for later in the year, despite the advantages associated with a competitively priced U.S. dollar and increased OPEC demand. The critical factor is the degree to which American firms have regained their competitive position in world markets during the past two years, and whether new exporters continue to exploit these markets during periods of weak domestic demand.

The import picture is blurred by the uncertain oil price outlook. U.S. oil import costs in 1980 are projected at nearly $80 billion, double the 1978 bill. While nominal non-oil imports may rise by only 6%, well below the projected inflation rate, total imports could expand 14%-15% as a result of a potential increase in the oil bill of 35%-40%. Thus, the United States will essentially be paying for more expensive energy by curtailing non-oil imports.

In the face of a widening merchandise trade deficit, the United States will again look to the services sector to generate sufficient income to shore up its current account. And indeed, earnings from direct investment, as well as receipts from such other services as transportation, should improve, albeit at a significantly slower pace. Instead of the massive increase in earnings from U.S. investment abroad chalked up in 1979, this year should witness only modest gains in this sector as foreign economic activity begins to moderate.

This year will prove to be a critical one for the U.S. external accounts. OPEC policies, recession at home and slowdown abroad, expectations of poor harvests, and other adverse influences all suggest a turning point for the U.S. external position. The problem is that these influences sometimes favor opposing external-account movements. Nevertheless, markets have in the past demonstrated great resilience in accommodating the stresses of world payments imbalances.